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No. 80-243

In the Supreme Court of the United States

OCTOBER TERM, 1980

UNITED STATES OF AMERICA, APPELLANT

v.

E.M. AND B.L. DARUSMONT

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF CALIFORNIA

REPLY MEMORANDUM FOR THE APPELLANT

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In seeking affirmance of the decision below, appellee argues (Mot. 6, 15-18) that the 1976 amendments to the minimum tax created a new tax that cannot reach transactions consummated prior to the date those amendments were signed into law. Second, appellee argues (*id.* at 6, 7-9) that despite the general rule upholding the application of income tax provisions to the entire year of enactment, an exception exists for "voluntary acts"—such as the sale of a residence—entered into prior to the date of enactment. Finally, appellee claims (*id.* at 6, 9-15) that he "had no notice, either actual or constructive" that the sale of his residence might have subjected him to the minimum tax and, consequently, that "imposition of the tax after the sale was arbitrary, harsh and oppressive" (*id.* at 15).

1. Contrary to appellee's first contention, the 1976 amendments to the minimum tax did not create a new tax. As we have noted (J.S. 8-9), the minimum tax was originally enacted in 1969. One of the original items of tax preference subject to the minimum tax was the untaxed portion of capital gain income. The only provisions changed in 1976 that affected appellee were the allowable exemption, which was decreased, and the percentage rate of tax, which was increased. Appellee therefore stands in a markedly different position from that of an individual who "has no reason to suppose that any transactions of the sort will be taxed at all" (*Cohan* v. *Commissioner,* 39 F. 2d 540, 545 (2d Cir. 1930)).

Furthermore, the minimum tax is an income tax which is intended to increase the income tax liability of persons whose regular income tax liability is disproportionately reduced as a consequence of claiming certain large deductions, *i.e.*, items of tax preference. See *Graff* v. *Commissioner,* 74 T.C. No. 58 (July 21, 1980), slip op. 40-44. Under the circumstances of this case, the economic effect of the 1976 amendments was to reduce somewhat the tax benefit of appellee's income tax deduction for fifty percent of net capital gains then permitted by Section 1202. That was not a new tax; it was only a change in the extent to which deductions would be allowed to decrease the impact of existing taxes. Under the decisions of this Court (see J.S. 6-7), it is well within Congress' authority to make such a change effective as of the beginning of the year of enactment.[1]

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[1]The minimum tax is imposed upon the sum of all the items of tax preference claimed for the taxable year. As in the case of the regular income tax, the minimum tax cannot be computed until after the close of the year.

2. Nor is it relevant that appellee's sale of his residence was a "voluntary act" (Mot. 9) that arguably might not have taken place (or might have taken a different form) if he or his advisors had considered the changed minimum tax provisions. Indeed, several of the Court's decisions upholding the application of income tax statutes to the entire year of enactment have dealt with "voluntary" acts. For example, in *Cooper* v. *United States*, 280 U.S. 409 (1930), the taxpayer, on November 7, 1921, sold stock that she had acquired by gift from her husband one week earlier. On November 23, 1921, however, Congress passed a revenue act providing that the basis of property received by gift after December 31, 1920, would be equal to that of the donor—*i.e.*, a carryover basis—instead of equal to the fair market value of the property at the time of the gifts, which had been the rule up until that date. Seeking to avoid using the lower carryover basis in computing her gain on the sale, the taxpayer argued that the new income tax provision should not be applied "to transactions fully completed before enactment of the statute" (280 U.S. at 411). This Court, however, rejected that contention, stating (*ibid.*): "That the questioned provision can not be declared in conflict with the Federal Constitution merely because it requires gains from prior but recent transactions to be treated as part of the taxpayer's gross income has not been open to serious doubt since *Brushaber* v. *Union Pacific R. Co.*, 240 U.S. 1, and *Lynch* v. *Hornby*, 247 U.S. 339."[2]

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[2]See *United States* v. *Hudson*, 299 U.S. 498 (1937) (voluntary sale of silver futures contracts held subject to special income tax provision enacted after the sale took place). See also *First National Bank in Dallas* v. *United States*, 420 F. 2d 725, 729-731 (Ct. Cl. 1970), where the court specifically rejected the claim that an income tax imposed on a voluntary act could not be applied retroactively.

Milliken v. *United States*, 283 U.S. 15 (1931), is to the same effect. There, in 1916, the decedent, in contemplation of his death, gave his children certain shares of corporate stock. Two years later in the Revenue Act of 1918, ch. 18, 40 Stat. 1057, Congress increased the estate tax rates for gifts made in contemplation of death. In holding that the new rates could be applied to the 1916 gifts, this Court rejected the taxpayer's arguments against application of the 1918 Act. As the Court stated (283 U.S. at 23):

> Not only was the decedent left in no uncertainty that the gift he was then making was subject to the provisions of the existing statute, but in view of its well understood purpose he should be regarded as *taking his chances of any increase in the tax burden* which might result from carrying out the established policy of taxation under which substitutes for testamentary gifts were classed and taxed with them. [Emphasis supplied.]

These decisions control this case and require reversal of the decision below.

3. It is therefore irrelevant whether appellee was aware of the impending changes in the minimum tax when he sold his residence. But, at all events, the public had ample notice of these changes. As we have pointed out (J.S. 9-10), on November 12, 1975—more than eight months prior to appellee's sale of his residence—Congress manifested its intention to increase the minimum tax rate and to reduce the allowable exclusions. See H.R. Rep. No. 94-658, 94th Cong., 1st Sess. 130-132 (1975). And on June 10, 1976, the Senate Finance Committee agreed in principle to the House proposals to increase the effective rate of the minimum tax. S. Rep. No. 94-938, 94th Cong., 2d Sess. 108-114 (1976). Each of these proposals,

moreover, provided that the changes in the minimum tax were to be effective for all taxable years beginning after December 31, 1975. Thus, prior to the time appellee sold his residence on July 15, 1976, it was public knowledge that the burden of the minimum tax liability likely would be increased with respect to transactions occurring during 1976.

For the reasons stated above and in our Jurisdictional Statement, probable jurisdiction should be noted.

Respectfully submitted.

WADE H. MCCREE, JR.
Solicitor General

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